No. 12078

IN THE

United States Court of Appeals

For the Ninth Circuit

WALTER TREPTE and MARGARET TREPTE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

REPLY BRIEF FOR THE PETITIONERS

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BRIEF FOR THE PETITIONERS

Opinion of the Tax Court

The memorandum findings of fact and opinion of the Tax Court of the United States (Tr. 28-51) are not officially reported.

Jurisdiction

This petition for review (Tr. 54-64) involves United States income and victory taxes for the calendar years 1942 and 1943. On August 23, 1946, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiencies in the total amounts as follows:

	Years	Amount	
Walter Trepte	1942-1943	$23,183.84	(Tr. 4)
Margaret Trepte	1942-1943	$29,480.82	(Tr. 16)

Within ninety days thereafter and on November 18, 1946, the taxpayers filed their petitions with the Tax Court of the United States for a redetermination of those deficiencies under the provisions of Section 272 of the Internal Revenue Code. (Tr. 4-26.) The decisions of the Tax Court sustaining the deficiencies were entered May 28, 1948. (Tr. 52, 53.) The case is brought to this Court by a petition for review filed August 23, 1948 (Tr. 54-64), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

Questions Involved

The questions involved are the same as set out in Brief for Petitioners, pages 2 and 3.

Statement

Petitioners briefly set out herein the most noticeable errors contained in the Summary of Argument and Argument presented in the brief for the Respondent.

Summary of Argument

THE SUMMARY OF ARGUMENT OF RESPONDENT IN HIS BRIEF IS SO ERRONEOUS WE FEEL IT IS NECESSARY TO CALL CERTAIN ITEMS THEREIN TO THE COURT'S ATTENTION. (RESP. BR. 16.)

Contrary to the Summary of Argument of the Respondent the entire Record supports the contention of the Petitioners that the Trepte Construction Co. copartnership was entered into and carried on in good faith, it was actual, real and bona fide, and entered into for the benefit of the co-partners with no thought of income taxes and with no purpose of dividing the family income to avoid, divide or defeat income taxes.

Walter B. Trepte worked diligently for his father, Walter Trepte, prior to January 1, 1942, the date of the formation of the co-partnership and worked steadily for the co-partnership during the taxable years involved and to date; whereas, Albert Eugene Trepte worked for his father prior to the formation of the co-partnership, January 1, 1942, but did not work steadily for the co-partnership during the taxable years involved or subsequent thereto, as his services for the co-partnership were interrupted while at school and during the period he was in the armed forces of the United States.

In spite of the fact that the Respondent constantly belittles the services of the two sons, one of the Petitioners herein, Walter Trepte, the father of the two sons, his associates, and officers in the armed forces of the United States as shown by the Record, were undoubtedly in a better position to gauge or determine the value of the services of each of the sons than one who is attempting to do so without actually seeing the vital and valuable services which were rendered. And further it is difficult to understand why the Respondent should underrate the services of Walter B. Trepte who was at various times Personnel Manager, Office Manager, representative for the co-partnership on numerous jobs, and assistant to his father in the operation of the co-partnership. At this time, after more than seven years have passed, the said sons, Walter B. Trepte and Albert Eugene Trepte, are still rendering vital and valuable services and each taking his share of the responsibility in the management and operation of the said co-partnership of which each is still a member. And to state that the services of Albert Eugene Trepte were negligible is grossly inconsistent with the Record, as the evidence shows that his services were vital and valuable. The responsibility placed on

the shoulders of Albert Eugene Trepte while serving in the United States Navy speaks for itself as to his ability.

The Respondent's Summary of Argument further states that the taxpayer, apparently meaning Walter Trepte, dominated the business subsequent to the formation of the co-partnership and exercised extensive control over the profits, assets, and every phase of the business operations and his economic status was unchanged, all of which is not in accord with the facts as set out in the Record, and further, Respondent overlooked the fact that when Walter Trepte's wife, Margaret Trepte became a co-partner in the business her share of the income from and after January 1, 1942 was obtained from the operations of the co-partnership instead of one-half of the community earnings of Walter Trepte.

The Respondent grossly erred wherein he stated: "Since the determination of the Tax Court that the partnership was not bona fide for federal revenue purposes is patently not clearly erroneous, it may not be disturbed on appeal", as this situation was changed by the removal of all traces of the Dobson decision (Dobson v. Commissioner, 320 U.S. 489, 88 L. Ed. 248, 64 S. Ct. 239), 1949 P-H Par. 21,820.

The last paragraph of the Summary of Argument of the Respondent is definitely misleading (Resp. Br. 16) as the Tax Court merely stated, "In view of our conclusion it becomes unnecessary to consider the second issue." (R. 51.)

Argument

I

THE RECORD DOES NOT SUPPORT IN ANY WAY THE DETERMINATION OF THE TAX COURT THAT THE FAMILY CO-PARTNERSHIP ESTABLISHED BY THE TAXPAYERS AND THEIR CHILDREN IS NOT BONA FIDE FOR FEDERAL REVENUE PURPOSES. THE RECORD CLEARLY SUPPORTS THE FACT THAT IT WAS A REAL, ACTUAL, LEGAL, VALID AND BONA FIDE CO-PARTNERSHIP FOR ALL PURPOSES.

Contrary to the statement of Respondent, the incoming partners, Walter B. Trepte and Albert Eugene Trepte, each invested capital originating with them, each rendered vital and valuable services, and each substantially contributed to the control and management of the business and did all things necessary and requisite to constitute a real, actual, legal, valid and bona fide co-partnership. (Resp. Br. 17.)

The Petitioners respectfully submit that so far as the Commissioner v. Tower, 327 U.S. 280, 290; Lusthaus v. Commissioner, 327 U.S. 293, are concerned all things were done to come within a bona fide partnership under rules set out in these two decisions. The control of the co-partnership business was in the four co-partners, and the profits were distributed to the said co-partners. The alienability of the partnership interests, and the motives leading to the formation of the partnership were the most honorable. It is a fundamental principle of law that a partnership agreement may provide for the alienability of interest or it may be dissolved by mutual consent or

an accounting had and the business of the partnership wound up. As to the motives, there can be none more honorable than that of a father and a mother to admit as members of a co-partnership their sons as was done in this case. The RECORD shows that the good will and integrity of the TREPTE name in the contracting and building trade has continued for nearly half a century, which distinctly and definitely shows co-operation and co-ordination in the family unit.

The Belcher v. Commissioner, 162 F. 2d 974 (C.A. 5th) (Decided 7-2-47) is not in point with the facts in the instant case. In the case cited, the family partnership consisted of Belcher, his wife as trustee for four minor children, and individually, and the trusts were created by the taxpayer, without contribution of capital or services by members of the family, except the wife who rendered only nominal services.

The Nordling v. Commissioner, 166 2d 703 (C. A. 9th) can readily be distinguished from the case before this Court. It was a husband and wife partnership and was not recognized for the reason that the wife's interest was purchased by her husband from his brother, a retiring partner. She later contributed only nominal services to the business.

As to the Blalock v. Allen, 151 F. 2d 927 (C. A. 5th) (Decided 12-3-45), the facts in this case have no similarity to the case now before this Court. A. O. Blalock, the father, 79 years of age, was made senior partner with no powers in the partnership affairs—he died in 1944.

Both, the Nordling case and the Blalock case were decided before the Dobson case ruling of the Supreme Court in 1943 was outlawed by Section 36, Public Law 773—80th Congress, 2nd session, approved June 25,

1948, effective September 1, 1948. (Resp. Br. 17 and 18.) (See 1949 P-H Par. 21,820.)

It is grossly unfair to state as the Respondent did in the first full paragraph of page 19 of his brief, that neither son rendered vital services to the business: "It is equally manifest that, as the Tax Court found (R. 48), neither son rendered vital additional services to the business. The most cursory analysis of the record suffices to demonstrate that the services rendered by Albert Eugene Trepte, who was sixteen years old at the time of the formation of the partnership, were negligible." Contrary to this statement, Walter B. Trepte was at various times Personnel Manager, Office Manager, representative for the co-partnership on numerous jobs and was fully recognized as assistant in every way to his father, one of the Petitioners herein. Albert Eugene Trepte was past the age of sixteen years and there is no doubt but that the father of the two sons, his associates, and officers of the armed forces of the United States were in a better position to judge and determine the vital and valuable services rendered by his two sons than one who only made a most CURSORY ANALYSIS of the records. Further, subsequent to the formation of the partnership the responsibility assigned to Albert Eugene Trepte while he was in the United States Navy would certainly indicate that the son had outstanding ability and for that reason it is difficult to understand why it is stated that his services were negligible. (Resp. Br. 19.)

The Respondent stated, "Thus during the greater part of the taxable years involved, 1942 and 1943, Walter B. Trepte did not work directly for the partnership". This statement is completely erroneous for the reason that during the years involved, namely, 1942 and 1943, Walter B. Trepte did work directly and diligently for

the co-partnership. Any compensation he received on any of the jobs upon which he was the representative of the co-partnership or otherwise, was either charged to him or the amount which he received was turned over to the co-partnership by him.

A very loose examination of the case of Mead v. Commissioner, 131 F. 2d 323, 324 (C. A. 5th) would disclose that it had no facts similar to those in the case now being considered as Mr. Mead personally withdrew most of the income. For 1937, the income was $10,504.21, he withdrew $9,771.61; for 1938, the income was $13,485.60, he withdrew $12,707.04; Mrs. Mead had no drawing account, took no part in the management or conduct of the business, made no contribution of capital, and no actual distribution of the partnership income was ever made. (Cited, Resp. Br. 22.)

In the middle of page 22, Respondent's Brief, he states: "The business involved millions of dollars at the time of the formation of the partnership. There is not an iota of evidence to indicate that the business was increased by virtue of the sons' activities."

It is true that the business involved millions; in fact, one job, NOY 4205, was approximately twenty-one millions of dollars. (R. 148.) There was no necessity for increasing the business, as the partnership had all it could handle at that time and that was one of the outstanding reasons why Walter Trepte Builder was anxious to form a co-partnership with his two sons as partners so they could assist him to carry on the business which was growing by leaps and bounds. It was necessary that he have persons around him in whom he could place implicit confidence and trust, and his two sons were the proper persons, as from childhood they had worked with their father, knew and understood much about the business.

The last sentence on page 22, Respondent's Brief, states: "Taxpayer, in effect, argues as if this Court were free to draw its own inferences without regard to findings of the Tax Court." The taxpayers still contend that this Court is free to draw its own inferences without regard to the findings of the Tax Court, and as authority for the petitioners' contention, cite H. R. 3214, which became Section 36, Public Law 773—80th Congress, 2nd session, approved June 25, 1948, effective September 1, 1948, which is also designated I. R. C. 1141, and reads as follows, to wit:

> "Courts of Review. (a) Jurisdiction.—The circuit courts of appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in Civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of title 28 of the United States Code."

The Respondent has conveniently overlooked the fact that I. R. C. 1141 removes all traces of the Dobson decision which originated in 1943, Dobson v. Commissioner, 320 U. S. 489, 88 L. Ed. 248, 64 S. Ct. 239. The Dobson decision, in effect, held that where the elements of a decision could not be separated so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand.

The new provision, Sec. 1141, is applicable to all decisions pending before the appellate court on September

1, 1948. In substance, all decisions prior to September 1, 1948 in which a Tax Court case was held to be final under the Dobson Rule, are now of practically no value as precedents. Some of those cases, no doubt, would be decided in the same way but for a different reason. It is quite evident that the Dobson Rule was so stringent and unjust that it was necessary for Congress to pass a law to remove all traces of the Dobson decision. (See 1949 P-H, Par. 21,820.)

The Eisenberg v. Commissioner, 161 F. 2d 506 (C. A. 3rd) case cited at bottom of Respondent's Brief, page 22, is not applicable to the instant case as it involves separate trusts for minor children and made the several trusts members of the partnership and the trustor retained dominion and control over the corpus of the trust. This is another case which falls within the Dobson rule as discussed supra.

The first full sentence at the top of page 24 of Respondent's Brief which reads, "Thus taxpayer and his wife could absolutely preclude the distribution of any profits to their two sons, while at the same time drawing from the business as much as they desired for themselves in salary", is rather an idle gesture on the part of the Respondent as he completely overlooked the fact that Margaret Trepte and her two sons who constitute the holders of a majority interest, could if they so desired, control whatever conditions or circumstances that may arise.

The first sentence in the first paragraph at top of page 25 of Respondent's Brief, which reads, "A mere reading of the partnership agreement suffices to demonstrate that the taxpayer never parted with any control over the business, its assets and the profits", does not only border on the ridiculous but is utterly ridiculous, as on the same

page, Respondent makes the statement, "Moreover, it is of significance to note that during the entire period from 1942 to 1946 only insignificant sums were withdrawn from the business by taxpayer's sons", and then makes a statement that the sum of $113,122.27 was added to the account of Walter B. Trepte and $113,122.26 was added to the account of Albert Eugene Trepte during this period, and in this connection, we respectfully refer to Brief for Petitioners, page 10, SUMMARY, which shows and is substantiated by the original book account of which a photostat copy is in evidence (Exhibits 13 and 15) that Walter B. Trepte's partnership share of income during the years 1942 to 1946 was $129,583.24, his withdrawals were $97,018.38, and to his original capital on January 1, 1942 in the sum of $29,941.17 which represents the purchase price of his interest in and to the Trepte Construction Co. co-partnership, there was added during the period 1942 to 1946, inclusive, $32,564.86, which brought his capital up to the figure, December 31, 1946, of $62,506.03, and Brief for Petitioners, bottom of page 12, SUMMARY, of the original book account of Albert Eugene Trepte, a photostat copy of which is in evidence (Petitioner's Exhibits 14 and 16) shows that during the said period his partnership share of income amounted to $112,122.26 and his withdrawals $74,153.89, his capital on January 1, 1942 was $29,941.17, which was the purchase price of his interest in and to the Trepte Construction Co. copartnership, to which there was added during the years 1942 to 1946, inclusive, the sum of $37,968.37 and his capital at the close of the year 1946 was $67,909.54. It is indeed difficult to comprehend why the Respondent should refer to the withdrawals of the two sons, Walter B. Trepte and Albert Eugene Trepte, as only insignificant

sums, when the former withdrew during the period 1942 to 1946, inclusive, $97,018.38 and the latter, $74,153.89.

(Note: Through some oversight the headings in connection with the Summary of Exhibit 13, page 7, of Petitioners' Brief are incorrectly placed above the proper column of figures. The headings should be placed as shown in connection with the Summary of Exhibit 14, page 8, of the said Brief.)

Respondent's Brief, page 26, first paragraph, third sentence, states, "Taxpayer testified that the transition from his individual business to the partnership was gradual. (R. 134)." Such a statement gives the wrong understanding to the testimony of the taxpayer. He did testify to the fact that the transition was gradual in that they did not immediately print new stationery or have new checks printed, but did have rubber stamps made to overstamp checks and letterheads that were already printed. The Trepte Construction Co. co-partnership was created on January 1, 1942 and from that date the business was so conducted and recognized.

Apparently the Respondent fails to recognize the doctrine of "pari materia", for the reason that on page 26, the second full sentence of his brief with the excerpt from the contract which reads: "Finally, as the Tax Court observed, the following paragraph of the partnership agreement would lend further support to the Commissioner's determination that the arrangement between taxpayer and his family was not intended as a partnership in the ordinary business sense. The paragraph reads as follows (R. 50, Ex. 1, p. 6):

> That any and all earnings from personal services outside of this family co-partnership shall be given

> due consideration in allocating partnership profits and losses",

does not give consideration to the remainder of Article 11 of the Articles of Co-partnership, and when the said paragraph is construed as a unit, it simply means that whatever earnings any co-partner shall have outside of the said co-partnership shall be given consideration before allocating compensation or remuneration to the co-partner for his services, in addition to his share or interest in and to the profits or losses of the said co-partnership.

Petitioners seriously object to the misstatement and a misconstruction of the testimony of Walter Trepte as set out on page 27 of Respondent's Brief, second sentence, which reads, "A reading of the record at pages 166-167 demonstrates that the lower court was not satisfied with taxpayer's testimony as to the tax considerations in the formation of the family partnership. At one point, in answer to the court's instruction that he state the extent to which he took into consideration the matter of dividing up income in forming the partnership, taxpayer testified: 'Well, I don't think we considered it particularly.' (R. 167)". We believe that the words, "court's instruction" were intended to be "court's interrogation", and further, Counsel for the Commissioner repeatedly attempted to obtain the answer which he desired, but was unable to do so, subsequently and just before the end of the hearing, the Court interrogated the witness, and we quote in this respect from page 167 of the Transcript of Record:

> "The Court: State to what extent, if any, you took into consideration the matter of dividing up income by forming a partnership arrangement?
>
> "The Witness: Well, I don't think we considered it particularly. The main thing was to have

the boys in the business, to carry on in the case of my death.

"The Court: You say you don't think you considered it particularly. That is rather a general answer. Tell me more particularly about that, whether you did or did not.

"The Witness: We did not."

In the last paragraph of page 27 of Respondent's Brief, he is again attempting to instruct this Court regarding its duties in the case now before the Court, but has not given due or proper consideration to the fact that the Dobson Rule became ineffective on September 1, 1948. (See 1949 P-H, Par. 21,820.)

On page 28 of Respondent's Brief he attempts to discredit the case of Culbertson v. Commissioner, 168 Fed. 2d 979 (C. A. 5th), and points out what he believes to be inconsistencies between its holdings and the U. S. Supreme Court's holdings in the Tower and Lusthaus cases supra, whereas if one studied the cases diligently he would no doubt find that they were not inconsistent and it was so determined by the learned judges of the 5th Circuit who gave mature and cautious consideration to the Tower and Lusthaus cases when deciding the Culbertson case.

After extensive study of decisions by the Tax Court of the United States in connection with family partnership cases, one must reach the conclusion that every time a family partnership case appears on the horizon, it will, by the Tax Court, most generally be decided against the petitioner, which no doubt was the reason for Congress to enact Public Law 773—80th Congress, 2nd session, which became effective September 1, 1948. Various tax services and tax letters often refer to the trend toward

more favorable treatment of family partnerships, the most recent of which stated in connection with bills to benefit taxpayers, "Family partnerships would be recognized if valid under the State laws." This trend is particularly noticeable in cases such as this one where the co-partnership consists of other members of the family rendering vital and valuable services than husband or wife only, as was the situation in both the Tower and Lusthaus cases.

As for the long list of cases set out as footnotes on pages 28 and 29 of Respondent's Brief, they were all decided prior to Sec. 36, Public Law 773—80th Congress, 2nd session, therefore, they are not applicable to the case now before this Court and further, in each and every instance the cases cited by Respondent, some fifty of them, are all distinguishable from the case now before this Court.

An examination of the cases cited shows that in most instances they come within the husband and wife category or a trust which is considered a member of the partnership wherein minor children are involved, or a mere assignment of income has been made and none of the said cases possess the facts as does the instant one wherein the sons contributed capital, rendered valuable and vital services, assumed responsibility, accepted their full share of the management and control of the operations of the business, were given their full division of the profits obtained through the operation of the business, and having had a family tradition in the operation of the same business for approximately a half of a century.

It is only natural that the Respondent should be so agreeable in accepting the MEMORANDUM FINDINGS OF FACT AND OPINION of the Tax Court of the United States as it is altogether in his favor, al-

though Petitioner contends that the Memorandum Findings of Fact and Opinion neither follow the fact nor the law. It should not be overlooked that the Tax Court of the United States and the Commissioner of Internal Revenue are both agencies of the executive branch of the Government.

Argument

II

On Page 30, Respondent's Brief, he makes the following statement:

> "TAXPAYER'S ATTEMPTED ASSIGNMENT TO THE PARTNERSHIP OF HIS INTEREST IN THE JOINT VENTURE KNOWN AS GOLDEN - TREPTE CONSTRUCTION COMPANY, WHOSE ASSETS CONSISTED OF GOVERNMENT CONSTRUCTION CONTRACTS, WAS INEFFECTIVE FOR TAX PURPOSES",

but does not support his statement with any applicable authorities.

As for the Wittenberg v. Commissioner case, decided December 13, 1944 (1944 P-H T. C. Memorandum Decision, Par. 44,293), it was partnership income which was assigned to the family trust. The taxpayer created three trusts for his three minor children to which he assigned a one-third interest in a partnership of which he was a member. The powers under the partnership agreement presented substantial doubt as to the freedom of the trust property from his dominion or control. It was obvious that neither the wife nor the children of the petitioner rendered any services. This case differs from the case now before this Court in that the Wittenberg case was strictly an assignment of income, whereas in the instant case it was an assignment of property.

The Lucas v. Earl, 281 U. S. 111; Earp v. Jones, 131 F. 2d 292; and Burnet v. Leininger, 285 U. S. 136, are readily distinguishable from the case being considered. In the Lucas case, husband and wife entered into a contract whereby they agreed that whatever each had or acquired in any way during the existence of the marriage should be received and owned by them as joint tenants. In the Earp case, the husband made a gift of a one-half interest in his business to his wife and a partnership agreement between his wife and himself was subsequently effected. The Burnet case was merely an equitable assignment on the part of Mr. Leininger to his wife of one-half of what he should receive from the partnership in which he was a member and an agreement by her to make good to him one-half of the losses he might sustain by reason of his interest in the partnership. As stated before, in the case now before this Court, the assignment was of property or a right to carry on the operations of the business, and not an assignment of income. Such action is supported, approved and allowed in the case of Iowa Bridge Co. v. Commissioner, 29 F 2d page 777.

Conclusion

The decision of the Tax Court of the United States should be reversed.

Respectfully submitted,

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